No. 96-1186

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IN THE
# Supreme Court of the United States
OCTOBER TERM, 1996

ASSOCIATED GAS DISTRIBUTORS, *et al.*,
*Petitioners,*
v.
FEDERAL ENERGY REGULATORY COMMISSION,
*Respondent.*

**On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit**

## REPLY OF PETITIONERS ASSOCIATED GAS DISTRIBUTORS, ATLANTA GAS LIGHT COMPANY, CHATTANOOGA GAS COMPANY, AND NORTHERN INDIANA PUBLIC SERVICE COMPANY

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8 pp

## TABLE OF AUTHORITIES


Cases: Page

*FPC v. Southern California Edison Co.*, 376 U.S. 205 (1964) ..... 3

*Federal Power Comm'n v. East Ohio Gas Co.*, 338 U.S. 464 (1950) ..... 1

*General Motors Corp. v. Tracy*, —— U.S. ——, 1997 U.S. LEXIS 692 (Feb. 18, 1997) ..... *passim*

*Louisiana Pub. Serv. Comm'n v. FCC*, 476 U.S. 355 (1986) ..... 3

Statutes:

15 U.S.C. § 717(b) ..... 2, 4

15 U.S.C. § 717(c) ..... *passim*

Other Authorities:

S. Rep. No. 817, 83d Cong., 1st Sess. (1953) ..... 2

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1. This Court recently reaffirmed that one of the central premises underlying the Natural Gas Act was Congress' desire to preserve for the States their "traditional autonomy to authorize and regulate local gas franchises." *General Motors Corp. v. Tracy*, —— U.S. ——, 1997 U.S. LEXIS 692 (Feb. 18, 1997), slip op. at 29. *See generally* slip op. at 23-34. This Court observed that Congress had reaffirmed that premise with the Hinshaw Amendment (codified at 15 U.S.C. § 717(c)). Reacting to the decision in *East Ohio Gas*,[1]

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[1] *Federal Power Comm'n v. East Ohio Gas Co.*, 338 U.S. 464 (1950).

> Congress amended the NGA to "leave jurisdiction" over "companies engaged in the distribution" of natural gas "exclusively in the States as always has been intended."

Slip op. at 28, *quoting* S. Rep. No. 817, 83d Cong., 1st Sess., 1-2 (1953). Under the terms of this grant of authority to regulate LDCs, "all 50 States recognize the need to regulate utilities engaged in local distribution of natural gas," and have typically imposed upon LDCs comprehensive obligations and restrictions reflecting state policy. Slip. op at 30-34.

2. The NGA thus contemplated two complementary, not overlapping, spheres of authority, one state and one federal. To the extent the States were assigned authority—as they were, under Section 1(c) to regulate LDC in-state sales—FERC has no authority to regulate. Because FERC has no authority to regulate in the area assigned to the States, it cannot preempt state regulation.

3. In issuing Order 636, FERC paid no heed to the grant of exclusive authority to the States in NGA Section 1(c), 15 U.S.C. § 717(c). Rather, it deemed it sufficient that FERC possessed an arguable basis for exercising authority to regulate the transactions in question under the language of NGA Section 1(b), 15 U.S.C. § 717(b).

Likewise, the Court of Appeals failed to address either the scope of state authority under NGA Section 1(c) or the significance of Congress' decision to preserve for the States a sphere of regulatory control free from federal intrusion. Instead, the lower court focused singularly on the language of Section 1(b) affirmatively describing the scope of FERC jurisdiction. In this way, it treated the apparent grant of authority to the States under Section 1(b) as merely the residuum of whatever was left over after construing the scope of federal agency power. It then went on, summarily, to treat Section 1(c) the same way, despite the fact that Section 1(c), by its terms, creates a sphere of authority "exempted" from the exercise

of federal authority. 15 U.S.C. § 717(c). The Court of Appeals' analysis thus did not take into account in any way the important state interests reflected in the NGA, and now highlighted in *General Motors Corp. v. Tracy*.

As shown in AGD's Petition, this was error, for it turns the state-federal structure of the NGA on its head. The Court of Appeals' analysis is improperly skewed in favor of a broad federal authority that can run roughshod over the state interests *expressly* protected by the NGA. *See* AGD Petition at 13-24.

4. Nonetheless, FERC's brief in opposition takes the same tack. It emphasizes FERC's asserted interest here in creating "uniformity" and highlights cases upholding FERC's authority over the "transportation of natural gas in interstate commerce." FERC Brief in Opposition at 10. In so arguing, FERC sidesteps the fact that NGA Section 1(c) is an exemption, and thus a limitation, on federal power—the effect of which was never addressed by FERC in Order 636, or by the Court of Appeals.[2] Indeed, only in passing does FERC here acknowledge that its so-called "plenary" transportation jurisdiction does *not* extend to transactions "which Congress has made explicitly subject to regulation by the States." FERC Br. in Opposition at 10, *quoting FPC v. Southern California Edison Co.*, 376 U.S. 205, 216 (1964).

5. As shown in the Petition, NGA Section 1(c), by its plain language, provides for exclusive state jurisdiction over (and federal authority "shall not apply to") "any person" coming within its terms, notably LDCs engaged in providing gas to be consumed within the State. 15 U.S.C. § 717(c). Thus, the NGA contemplates comprehensive state regulatory authority over LDCs in their relations with in-state customers. In its brief in opposition,

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[2] "To permit an agency to expand its power in the face of a congressional limitation on its jurisdiction would be to grant to the agency power to override Congress." *Louisiana Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 374-75 (1986).

FERC argues about whether an LDC's sale of capacity rights to its in-state customer qualifies as "local distribution" under *Section 1(b)*. FERC Br. in Opposition at 13. But FERC offers no interpretation of the language of *Section 1(c)* that would somehow avoid the exclusive authority that the States exercise over LDCs and their local facilities in connection with gas consumed within the State.

6. FERC does assert that for Section 1(c) to apply, the "service at issue would have to be subject to *effective state regulation*." FERC Br. in Opposition at 16. FERC then defines "effective" in terms of the States' inability to "prevent interstate pipelines from discriminating in favor of in-state users at the expense of out-of-state users." *Id.*

Contrary to FERC's suggestion, Section 1(c) does not specify "effective state regulation." It requires merely "that the rates and service of such person *be subject to regulation* by a State commission." 15 U.S.C. § 717(c).[3]

Moreover, judging "effectiveness" on the basis of whether the States can prevent "interstate pipelines" from discriminating, defines the test in a way that it can never

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[3] FERC does not suggest that States have not, in fact, regulated capacity sales by LDCs to in-state customers. FERC's quibble turns on its addition of the word "effective."

Examples of state regulation over LDC capacity sales were cited in AGD's Petition at 10 n.4. As it affects capacity sales, these examples show that the States have established (a) processes for allocating LDC surplus pipeline capacity rights among industrial customers that have acquired their own "unbundled" gas supply; and (b) rate regulation to control both amounts paid by local end users for pipeline capacity rights acquired from LDCs *and* the disposition of the revenue from such transactions for the benefit of captive consumers.

Order 636, of course, preempts most of these state regulatory measures by imposing a federal procedure for LDCs' allocation of capacity among local consumers *and* federal rate regulation to fix the maximum amount an LDC may collect from those customers for this service.

be met: The States have no jurisdiction over "interstate pipelines" generally. Their jurisdiction is over LDCs and LDC service to in-state customers, including pipeline capacity that the LDCs would continue to use for service to their in-state customers. By its nature, state regulation can only address "in-state users" and, of necessity, cannot address discriminations between "in-state" and "out-of-state" users. Indeed, by assigning regulatory authority to the States, Congress necessarily gave precedence to the States' interest in regulating in-state uses over whatever benefits—in terms of national uniformity and prevention of discrimination between in-state and out-of-state users—might have flowed from a plenary grant of authority to FERC over *all* aspects of the natural gas market. It is inherent in the NGA that sometimes these federal interests must give way.

7. As the Court recounted in *General Motors Corp.*, regulatory developments, encouraging the "unbundling" of gas sales, have changed certain marketing practices in the gas industry. They have prompted the precise situation addressed here, where an LDC seeks to service its in-state customer, not with bundled gas, but by sale of firm pipeline capacity needed by the in-state customer. Though this restructuring of the industry would expectably produce some disharmony in the fit between market structure and the NGA provisions preserving traditional state authority, the language of Section 1(c) still rings true. Moreover, the basic intent of that provision, to provide for exclusive state authority over the relationship between LDCs and their customers—clearly subject to state regulation—is undiminished by these changes in the structure of the market. The authority of the States, and the purpose of these provisions preserving state authority, cannot simply be ignored. Yet that is exactly what both FERC and the Court of Appeals did in upholding Order 636. The result fundamentally undermines the States' comprehensive regulatory control over LDCs' service to in-state customers.

Given Congress' express reservation of power to the States, FERC's exercise of power, disrupting the regulatory scheme applicable to natural gas service in all 50 States, presents an issue of fundamental importance. In light of the federal circuit court's decision to ignore these state interests under the NGA, it is incumbent upon this Court to ensure that the interest of the States is both respected and reflected in the federal regulatory scheme.

## CONCLUSION

The petition for issuance of a writ of certiorari should be granted.

Respectfully submitted,

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